DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 02-0306
Financial Institutions Tax
For the Tax Years 1993 through 1998

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ISSUES

I. Constitutionality of the Financial Institutions Tax.

Authority: U.S. Const. art. I, § 8; Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1974); IC 6-5.5-1-12, 13; IC 6-5.5-1-17(a); IC 6-5.5-2-1(a); IC 6-5.5-2-2; IC 6-5.5-2-3; IC 6-5.5-3-1(6).

Taxpayer argues that, as an out-of-state entity with no physical presence within Indiana, the assessment of Financial Institutions Tax (FIT) is violative of the Commerce Clause.

II. Computational Errors.

Authority: IC 6-8.1-5-1(b)

Taxpayer challenges the calculation of FIT on the ground that the audit made computational errors resulting in an over-assessment of the amount of tax due.

III. Abatement of the Ten-Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer requests that the Department of Revenue (Department) exercise its discretion to abate the ten-percent negligence penalty imposed at the conclusion of the audit examination.

STATEMENT OF FACTS

Taxpayer consists of a group of affiliated companies engaged in the business of offering various credit card services. Taxpayer receives income from Indiana customers based on the performance of those services. Taxpayer maintains its headquarters at an out-of-state location. One of taxpayer's affiliates was engaged in the business of extending loans on personal and real property within Indiana and had previously paid Indiana corporate income taxes.

The Department conducted an audit review of taxpayer's business records. The Department concluded that taxpayer was conducting the business of a financial institution within the state and assessed FIT accordingly. The taxpayer disagreed with the Department's conclusion and submitted a protest to that effect. An administrative hearing was held during which taxpayer explained the basis for its protest. This Letter of Findings follows.

DISCUSSION

I. Constitutionality of the Financial Institutions Tax.

Pursuant to the audit's examination of taxpayer's business records, the Department concluded taxpayer was engaged in the business of a financial institution within Indiana and was subject to the FIT. Taxpayer challenges this conclusion on the ground that it has no "substantial nexus" with Indiana and that imposition of the tax offends the Commerce Clause. (U.S. Const. art. I, § 8).

Within Indiana, "There is imposed on each taxpayer a franchise tax measured by the taxpayer's adjusted gross income or apportioned income for the privilege of exercising its franchise or the corporate privilege of transacting the business of a financial institution in Indiana." IC 6-5.5-2-1(a).

For purposes of the FIT, a "'[t]axpayer' means a corporation that is transacting the business of a financial institution, including any of the following:

> (1) A holding company.
> (2) A regulated financial corporation.
> (3) A subsidiary of a holding company or regulated financial corporation.
> (4) Any other corporation organized under the laws of the United States, this state, another taxing jurisdiction, or a foreign government that is carrying on the business of a financial institution." IC 6-5.5-1-17(a).

The FIT is imposed on both "nonresident taxpayers" and "resident taxpayers" transacting business within this state. IC 6-5.5-1-12, 13. The statute defines a "nonresident taxpayer" as "a taxpayer that (1) is transacting business within Indiana as provided in IC 6-5.5-3; and (2) has its commercial domicile outside Indiana." A resident taxpayer, not filing a combined return, determines its FIT liability based on the resident taxpayer's adjusted gross income from whatever source derived. IC 6-5.5-2-2. In contrast, a nonresident taxpayer determines its FIT liability based on its apportioned income consisting of the taxpayer's adjusted gross income "multiplied by the quotient of (1) the taxpayer's total receipts attributable to transacting business in Indiana . . . divided by (2) the taxpayer's total receipts from transacting business in all jurisdictions . . . ." IC 6-5.5-2-3.

The FIT definition of "transacting business" within this state includes the activities of a company which "regularly engages in transactions with customers in Indiana that involve intangible property, including loans . . . [that] result in receipts flowing to the taxpayer from within Indiana." IC 6-5.5-3-1(6).

Taxpayer challenges the FIT assessment on the ground that it does not have a substantial nexus with Indiana. In Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1974), the Supreme Court stated that a tax will not be deemed to interfere with interstate commerce when it is "applied to an activity with a substantial nexus within the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state." Id. at 279. Taxpayer's protest is based on the assertion that it does not have the minimum connection with the state necessary to establish the requisite "substantial nexus."

To the extent taxpayer maintains that Indiana's FIT is – on its face – inapplicable, the Department must disagree. Under IC 6-5.5-3-1, IC 6-5.5-1-12, and IC 6-5.5-1-17, taxpayer falls squarely within the definition of a non-resident entity conducting the business of a financial institution within this state; consequently, taxpayer is liable for FIT on the income derived from sources within Indiana.

To the extent taxpayer challenges the constitutionality of the FIT as applied to non-resident businesses having only an economic nexus with Indiana, the Department declines to address the question. An administrative hearing conducted by the Department of Revenue is not the appropriate forum in which to address this constitutional challenge.

FINDING

Taxpayer's protest is respectfully denied.

II. Computational Errors.

Taxpayer challenges the tax assessment on the ground that the audit report contained substantive, computational errors. Taxpayer maintains that errors occurred in calculating the apportionment numerator and that three pages of the audit's worksheets contain numerical misstatements or omissions.

IC 6-8.1-5-1(b) states that, "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

The administrative hearing is not the means by which purported computational errors may be analyzed, corrected, or refuted. Nonetheless, taxpayer has met its burden under IC 6-8.1-5-1(b) of demonstrating that its assertion is not frivolous or entirely groundless. Accordingly, the audit division is requested to conduct a supplemental review of the specific claimed errors and make whatever corrections it deems necessary.

FINDING

Subject to the results of the supplemental audit, taxpayer's protest is sustained.

III. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer urges the Department to abate the ten-percent negligence penalty arguing that “the current status of all economic nexus based taxes, including Indiana’s Financial Institution Tax, support the finding that no filing requirement exists for out-of-state financial institutions such as [taxpayer].”

IC 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer’s negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as “the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer.” Negligence is to “be determined on a case-by-case basis according to the facts and circumstances of each taxpayer.” Id.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on “reasonable cause and not due to willful neglect.” Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish “reasonable cause,” the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . .”

Taxpayer did not file FIT tax returns, was audited during 2001, and was assessed for six years of unpaid taxes. Taxpayer is a substantial, sophisticated business receiving large amounts of money from sources within Indiana. Taxpayer’s larger constitutional question aside, the decision to simply ignore this state’s FIT is not the evidence of the “ordinary business care and prudence” expected of an “ordinary reasonable taxpayer” that would warrant abatement of the ten-percent negligence penalty.

FINDING

Taxpayer’s protest is respectfully denied.

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